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**RECLAIMING THE INTENT :
TAX INCREMENT FINANCE IN THE KANSAS CITY
AND ST. LOUIS METROPOLITAN AREAS**

Thomas Luce
Ameregis, Inc.

A Discussion Paper Prepared for
The Brookings Institution Center on Urban and Metropolitan Policy

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EXECUTIVE SUMMARY

Tax increment finance (TIF) is a popular and potentially powerful tool for places that need economic development the most yet have the least to spend. By allowing jurisdictions to use portions of their tax base to secure public-sector bonds, the mechanism allows fiscally strapped localities to finance site improvements or other investments so as to “level the playing field” in economic development.

However, poorly designed TIF programs can cause problems. Not only can they increase the incentives for localities to engage in inefficient, zero-sum competition for tax base with their neighbors. Also, lax TIF rules may promote sprawl by reducing the costs of greenfield development at the urban fringe. It is therefore critical that state legislatures design TIF rules well.

In view of this, an analysis of the way TIF is designed and utilized in Missouri shows that:

- **Missouri law creates the potential for overuse and abuse of TIF.** Vague definitions of the allowable use of TIF permit almost any municipality, including those market forces already favor, to use it. Weak limits on its use for inefficient inter-local competition for tax base touch off struggles between localities. And the inclusion of sales tax base in the program tilts it toward lower-wage jobs and retail projects, which rarely bring new economic activity into a region.
- **Thanks to these flaws, TIF is used extensively in high-tax-base Missouri suburban areas with little need for assistance in the competition for tax base.** This is especially true in the St. Louis metropolitan area. There, TIF money very frequently flows to purposes other than combating “blight” in disadvantaged communities—its classic purpose. In fact, less than half of the 21 St. Louis-area cities that were using TIF in 2001 were disadvantaged or “at-risk” when evaluated on four indicators of distress. On another measure, just seven of the 20 suburban areas using TIF fell into the “at-risk” category.
- **TIF is also frequently being used in the outer parts of regions—particularly in the St. Louis area.** Most notably, only nine of the St. Louis region’s 33 TIF districts lie in the region’s core. Conversely, 14 of the region’s 38 TIF districts lie west of the region’s major ring road (I-270). These districts, moreover, contain 57 percent of the TIF-captured property tax base in the region. By contrast, the Kansas City region shows a pattern more consistent with the revitalization goals of TIF. The vast majority of the districts lie in the region’s center city, though the huge size of the city means many are still geographically far-flung.

In sum, poorly designed TIF laws are being misused at a time when state and local fiscal pressures require every dollar be spent prudently. As a result, a potentially dynamic tool for reinvestment in Missouri’s most disadvantaged communities threatens to become an engine of sprawl as it is abused by high-tax-base suburban areas that do not need public subsidies.

For these reasons, Missouri would be well-served by significant reforms in the laws governing TIF:

- **The allowable purposes for TIF should be more strictly defined to target its use to places with the most need for economic development.**
- **Higher level review of local determinations that TIF subsidies will support net contributions to the regional or state economy (the “but-for” requirement) should be implemented.**
- **Local TIF administrators should be required to show that TIF subsidies are consistent with land-use and economic development needs both locally and in nearby areas.**

If such reforms were put in place, TIF could be returned to its attractive main purpose: that of providing resources that would not otherwise be available to localities that badly need them to promote needed economic development and redevelopment.

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**RECLAIMING THE INTENT:
TAX INCREMENT FINANCE IN THE KANSAS CITY AND ST. LOUIS METROPOLITAN AREAS**

I. INTRODUCTION

Tax increment finance (TIF) is a method to finance part of the public and private costs associated with local economic development. It does this by removing tax base increases in areas designated as TIF districts from the general tax roles and using the revenues from this “captured” tax base to finance site improvements or other economic development costs. In the standard model, public-sector bonds are used to raise the money needed to finance site improvements at the beginning of the project. The revenues from the captured tax base are then used to repay the bonds. When the bonds have been retired, the captured tax base reverts to the general tax roles.

This study shows how TIF has been used in the St. Louis and Kansas City metropolitan areas. The following section, Section II, describes TIF in some detail, summarizes the pros and cons of the mechanism, and discusses three issues of special concern—allowable purposes for TIF districts, the “but-for” clause and project evaluation. Section III summarizes TIF rules in Missouri, describes the distribution of TIF activities in the Kansas City and St. Louis metropolitan areas and evaluates the effect of TIF on state aid to school districts in the areas that use TIF. Section IV provides concluding comments.

II. ADVANTAGES AND DISADVANTAGES OF TIF

TIF is a popular tool for local governments because it provides a way for them to finance local economic-development initiatives by means other than disbursements from current tax revenues.¹ Indeed, from the local point of view, TIF appears to be a costless (or very low cost) way to finance economic-development programs—if tax base increases in the TIF district would not have occurred without the site improvements, then the money used to finance the bonds would not have been available in the absence of TIF. In other words, if the new tax base in a TIF district is truly base that would not have been available without the TIF funding, the local government gets something (funds for economic-development programming) for nothing (no decrease in the funds available for other purposes).

This feature of TIF is both its primary strength and its major weakness. It is a strength because TIF generates funding for economic-development activities that otherwise might not be available (especially at a time when assistance of this sort from higher levels of government is declining). This is especially important in fiscally stressed places that both need the economic development the most and have the fewest resources to spend. It is a weakness because it reduces the apparent costs of economic development activities that often generate no net additions to the overall regional or state economy. When the economic activity encouraged by TIF funding represents activity that would have occurred somewhere else in the metropolitan area or the state, then from the point of view of metropolitan or state officials, the TIF funding is simply an unneeded public subsidy. The larger the geographic scope of your point of view, the more likely it is that TIF will be viewed as simply another tool in the zero-sum competition for tax base that goes on in every part of the country.

One implication of the potential zero-sum nature of TIF benefits relates to school finance. If state governments distribute aid to localities or school districts based on local tax bases (excluding base captured in a TIF district), then total state aid is likely to be greater than it would have been in the absence of TIF. For instance, if a business locates in a TIF district in a St. Louis-area suburb and generates \$1 million in TIF-captured tax base, this \$1 million dollars of tax-base is not counted in the state school aid formula that determines the amount of aid received by the local school district. However, if that business had located in St. Louis (outside of any TIF district), then it would have been counted in the tax base used to calculate school aid to St. Louis, reducing the amount of aid received there. In general, the net effect of a business locating in a TIF district rather than outside of a TIF district is an increase in total school aid distributed by the state.²

TIF offers other important advantages. It is a powerful and flexible way for state and local governments to direct economic-development resources where they are most needed. It is powerful because it leverages private resources—TIF bonds are repaid with tax revenues generated by the

¹ By 1999 44 states had TIF legislation. Goshorn, Julie A. "In a TIF: Why Missouri Needs Tax Increment Financing Reform" *Washington University Law Quarterly* 77, p. 925.

² The actual situation in Missouri is more complicated than this because of the special treatment of selected "held harmless" school districts in the school aid formula. See Section III, part B.

private development fostered by the TIF district. It is flexible because the generated funds can be spent on a wide variety of activities, while many intergovernmental funding sources come with strings attached. In the end, local officials—the players best able to evaluate special local circumstances—determine how the money is spent.

Another strength of TIF is that projects it supports must weather a market test of a sort not often applied to spending from general fund budgets. Local economic-development officials must evaluate TIF projects to ensure that they will (or will be very likely to) generate the added tax base needed to finance the TIF bonds. If TIF expenses are financed with general obligation (GO) bonds—bonds backed by the assets of the issuing government—and the project fails to capture enough new tax base to finance the TIF bonds, the bonds must still be redeemed at some point from general revenues. Similarly, if TIF bonds are financed by revenue bonds—bonds backed only by the expected revenue stream from the project—then questionable projects are unlikely to generate support from private investors concerned with protecting their investment.

To be sure, economic-development projects funded from a city's annual general fund—for instance, from the local economic-development agency's annual budget—must also weather the reviews built into the budget process. However, this process is unlikely to compare the required current expenditures to the resulting future revenue increases in as rigorous a manner as TIF funding because failure would not put the same “lien” on future revenues that a TIF bond does.

The upshot of these advantages and disadvantages, then, is that states must design TIF rules well. Three related issues stand out: (1) the definition of allowable purposes for TIF districts; (2) the definition of “new” activity, or activity that would have occurred “but-for” the TIF subsidies; and (3) project evaluation requirements.

A. Allowable Purposes for TIF Districts

If TIF is to be something other than just another means for localities to “beggar-thy-neighbor” in the competition for tax base, it must be targeted in ways that limit its use to places with a compelling need for assistance in this competition. Different states define allowable purposes in a variety of ways, usually based either on the characteristics of the area to be included in the TIF district or the purposes for which the TIF funds will be used.

Local characteristics commonly used to define allowable purposes include blight (usually defined as fully developed areas with a significant percentage of substandard or vacant buildings), brownfields (areas with soil or other environmental remediation required) or activity in a targeted industry (usually declining industries such as manufacturing or mining). Allowable spending categories often include activities like low-income housing or industry retention. In addition, most states (including Missouri) also add the catch-all “economic development” as an allowable purpose. This category, or one like it, is often the loophole that enables non-stressed places to use TIF for greenfield development.

B. The “But-For” Clause

Most states require that TIF be used only to subsidize economic development that would not have occurred without the subsidy. The intent is to prevent TIF funds from being used simply to shift economic activity around a region in a zero-sum competition for tax base. Unfortunately, the “but-for” requirement is inherently difficult to verify. As a result, it often consists of little more than a requirement that TIF funds not be used to lure existing firms from another location within the same region or state.

The difficulty of enforcing the “but-for” requirement makes it very important to carefully define TIF’s allowable purposes. One way to minimize the costs of the violations of the “but-for” clause is to carefully target TIF to geographic areas that are struggling or where development or redevelopment is expensive but desirable for social reasons (such as redeveloping brownfields in areas with high unemployment). Another is to limit subsidies to activities that private markets do not serve well (such as very low-income housing). The difficulty in policing the “but-for” requirement is the primary reason that vague allowable purposes like “economic development” create so much potential for TIF to be misused.

C. Project Evaluation

There are two important parts of a good project review—appraising the financial viability of the project and evaluating the underlying economic development value of the proposed activity.

Because TIF often involves the use of GO bonds that put public assets at risk, it is very important that TIF projects be evaluated thoroughly enough to ensure a high likelihood that the TIF subsidies will generate the new tax base needed to finance the bonds. TIF projects that fail to do this increase local fiscal stress by requiring that funds be diverted from other purposes to finance the bonds. The need for thorough evaluation inevitably increases the difficulty and costs of TIF as an economic-development tool.

One way to ensure the proper evaluation is to require that TIF districts use only revenue bonds, rather than GO bonds. The use of revenue bonds forces TIF projects to pass a market test—potential investors must be convinced of the viability of the project itself, not simply of the financial viability of the issuing government. If an adequate evaluation of the project is not available or if the evaluation implies that the risk of default is significant, then investors are likely to require junk-bond level returns—very high interest rates that increase the costs of the project.

Because TIF is a financial tool, it is tempting to evaluate TIF projects on that basis alone. However, a potential TIF project should also be evaluated by how well it serves local land-use needs and by the net economic benefits it generates. The fact that a project that is viable financially does not necessarily imply that it represents the best use of available resources (such as land and public funds) or even that it is worth doing at all. For instance, a project that results in retail development that increases tax base by enough to pay off the public costs of the project—meaning that it is

financially viable—may also consume land that would more appropriately be used for other purposes while generating only very low paying (or temporary) jobs with no real possibility of advancement for the workers that get them. In short, TIF projects should be evaluated in the context of a local land-use plan that specifies the preferred distribution of local economic activity and in the context of an economic development plan that spells out a preferred path for the local economy.

All of the issues described in this section interact in important ways. For instance, if the allowable purposes for TIF limit its use to areas with very high unemployment or other social needs, then the “but-for” requirement becomes less important because the economic-development activities are being targeted to areas where the social value is greatest. Similarly, if a way can be found to enforce the “but-for” requirement, then TIF is unlikely to be used for greenfield development in prosperous areas where development subsidies are unneeded.

III. TAX INCREMENT FINANCE IN MISSOURI

Missouri's TIF law is typical in some ways and unusual in others. The conventional features include the menu of allowable purposes for TIF and the treatment of the "but-for" requirement. A less common—and important—characteristic is the provision that allows localities to capture tax increments for taxes other than the property tax.

Allowable Purposes for TIF Districts: Missouri law allows localities to designate TIF districts in areas that fit into at least one of three designations: blight, conservation, and economic development. A blighted area is defined by statute as "an area which, by reason of the predominance of defective or inadequate street layout, unsanitary or unsafe conditions, deterioration of site improvements, improper subdivision or obsolete platting, the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, morals or welfare in its present condition and use."³

The definition of conservation area is more specific. It requires that 50 percent or more of the buildings in the district must be 35 years old or more and that the area is likely to become a blighted area.⁴

To qualify as an economic development area, there must be a finding by the municipality that TIF will not be used to compete unfairly for tax base and that the economic-development activities are in the public interest because they discourage economic activity from leaving the state, increase local employment or preserve the local tax base. Finally, the TIF redevelopment area must have experienced either population decline or a decrease in the value of real property (inflation adjusted) during the 20 years prior to designation.⁵

Missouri's menu of allowable purposes is thus fairly typical. Most importantly, the menu is not especially restrictive. It is likely, for instance, that at least some part of most municipalities, even places that market forces already favor, could qualify for TIF under one or more of the allowable purposes. Overuse of the blight designation has come under particular criticism.⁶

³ MO. REV. STAT. § 99.805.1 (1994).

⁴ MO. REV. STAT. § 99.805.2 (1994).

⁵ MO. REV. STAT. § 99.805.2 (1994). See also Goshorn, Julie A. "In a TIF: Why Missouri Needs Tax Increment Financing Reform," *Washington University Law Quarterly* 77, 919–946 and Missouri Department of Economic Development, "Tax Increment Financing Program." Available at www.ded.state.mo.us/communities/communitydevelopment/pdfs/tif.pdf

⁶ See Goshorn, p. 923. Two local reviewers of this research also cited this as a serious concern.

The “But-For” Clause and Project Evaluation: The Missouri TIF statute requires that the local TIF commission prepare a redevelopment plan and determine whether TIF is needed to make the project feasible—whether the project would not occur “but for” the TIF funding. The “but-for” requirement may be met in several ways, “such as the lack of development at the project site; additional costs of redevelopment; lack of private funds for the project; a projected pro-forma indicating that the projected return on investment (without the TIF assistance) is below a market rate of return, or other methods.”⁷

There are at least three serious shortcomings in this articulation of the “but-for” clause and the project evaluation element. First, the “but-for” determination is strictly local. It is the responsibility of the local TIF commission and the law makes no allowance for higher level review. This means that regional or state-level zero-sum concerns—the possibility that the development would occur elsewhere within the region or the state in the absence of the local subsidy—receives no consideration. Second, even the local “but-for” hurdle is vague and set very low. For instance, sites that meet the “lack of development at the project site” requirement could potentially include greenfield sites in relatively affluent areas. Finally, the redevelopment plan required by the law includes only the TIF site, with no reference to adjoining areas. While TIF commissions may have some incentive to relate TIF plans to more general local economic development objectives, they are not required to do so and they have no incentive to consider such concerns beyond municipal boundaries.

Potential Revenue Streams: As in most states, Missouri TIF districts may capture up to 100 percent of the increment in real property taxes generated by TIF-supported development. However, unlike most states, the Missouri law also allows districts to capture 50 percent of local sales and utility tax increments.⁸ This creates an incentive for TIF users to implement sales-tax-intensive development strategies.⁹ In most cases, this means retail development, a type of development that creates few high-wage jobs with strong career tracks. Competition for retail development is also very likely to represent a zero-sum game from the point of view of the region or the state—new development in one part of the region/state is likely to simply be displacing activity in another part of the region/state.

⁷ Missouri Department of Economic Development, “Tax Increment Financing Program,” p. 2. Available at www.ded.state.mo.us/communities/communitydevelopment/pdfs/tif.pdf

⁸ Districts in St. Louis and Kansas City may also capture the increment in local income taxes—they are the only localities in the state with the authority to tax income.

⁹ Municipalities in the Kansas City and St. Louis metropolitan areas that use the sales tax rely very heavily on the tax. In 1998, municipal sales tax revenues exceeded municipal property tax revenues by a factor of 2.8 in those places.

A. Distribution of TIF Districts and Captured Tax Base

As of February 1, 2001, there were 125 TIF districts in Missouri that had used a total of \$341 million in TIF increments to finance economic-development costs.¹⁰ Seventy-three of the 125 districts were designated as blighted, 24 were conservation areas, 11 were economic-development areas, and 15 were combinations of more than one designation.

TIF districts were located disproportionately in the Kansas City and St. Louis metropolitan areas. Eighty-nine of the 125 districts were in the two metropolitan areas: 40 in the city of Kansas City, 10 in Kansas City suburbs, six in St. Louis, and 33 in St. Louis suburbs. By 2000, some tax base had actually been captured in 76 of these 89 TIF districts. Table 1 shows the distributions of these districts by city and sector. The data show a relatively wide range of uses for TIF, with retail, office and combined office, and retail the most common. The extensive use of TIF for retail development is noteworthy given that retail development is unlikely to represent new activity in the regional economy that would not have occurred without the TIF subsidies.

Maps 1 through 4 show the geographic distribution of TIF districts and captured base in the two metropolitan areas. Table 2 shows a municipality-level summary of the TIF-captured tax base. The Kansas City metropolitan area shows a pattern very consistent with the generally stated goals of TIF. The vast majority of the districts lie in the core of the region—80 percent are located in Kansas City and 14 percent are located in first-ring suburbs (though the huge size of the city means many districts are still geographically far-flung). Only three districts lie in municipalities that do not border Kansas City—two in Excelsior Springs and one in Kearney—and these districts contain just 6 percent of the TIF-captured tax base in the region. (See Appendix A for a description of the methods used to compute TIF-captured tax base.)

The St. Louis region shows a much greater predominance of TIF districts in outer parts of the region. Only nine of the region's 33 TIF districts are in the region's core—six in the city of St. Louis, and three in Maplewood, a suburb bordering the city. These nine districts represented just 15 percent of TIF-captured tax base in the region. Conversely, 14 of the region's 38 TIF districts are outside the region's major ring road (I-270), and these districts contain 57 percent of the TIF-captured property tax base in the region.¹¹

Although there are a greater number of TIF districts in the Kansas City region, communities in the St. Louis area have captured a significantly greater share of total tax base in TIF districts—10 percent, compared to 5 percent in Kansas City. Six St. Louis municipalities show capture rates in excess of 10 percent, compared to just one in Kansas City.¹²

¹⁰ Missouri Department of Economic Development, *2000 Annual Report: Tax Increment Financing Projects in Missouri*, p. 1. Available at <http://www.ecodev.state.mo.us/cd/finance/tif.htm>. Reviewers noted that this source may not include all TIF districts in the state.

¹¹ Districts outside I-270 include those in Hillsboro, St. Charles, St. Peters, Chesterfield, Eureka, Ballwin, Fenton, Hazelwood, and Wentzville.

¹² The single very high capture rate in the Kansas City region—37 percent in Excelsior Springs—is the result of a very high measured rate for the sales tax base. This percentage may be the result of incorrect reporting in the

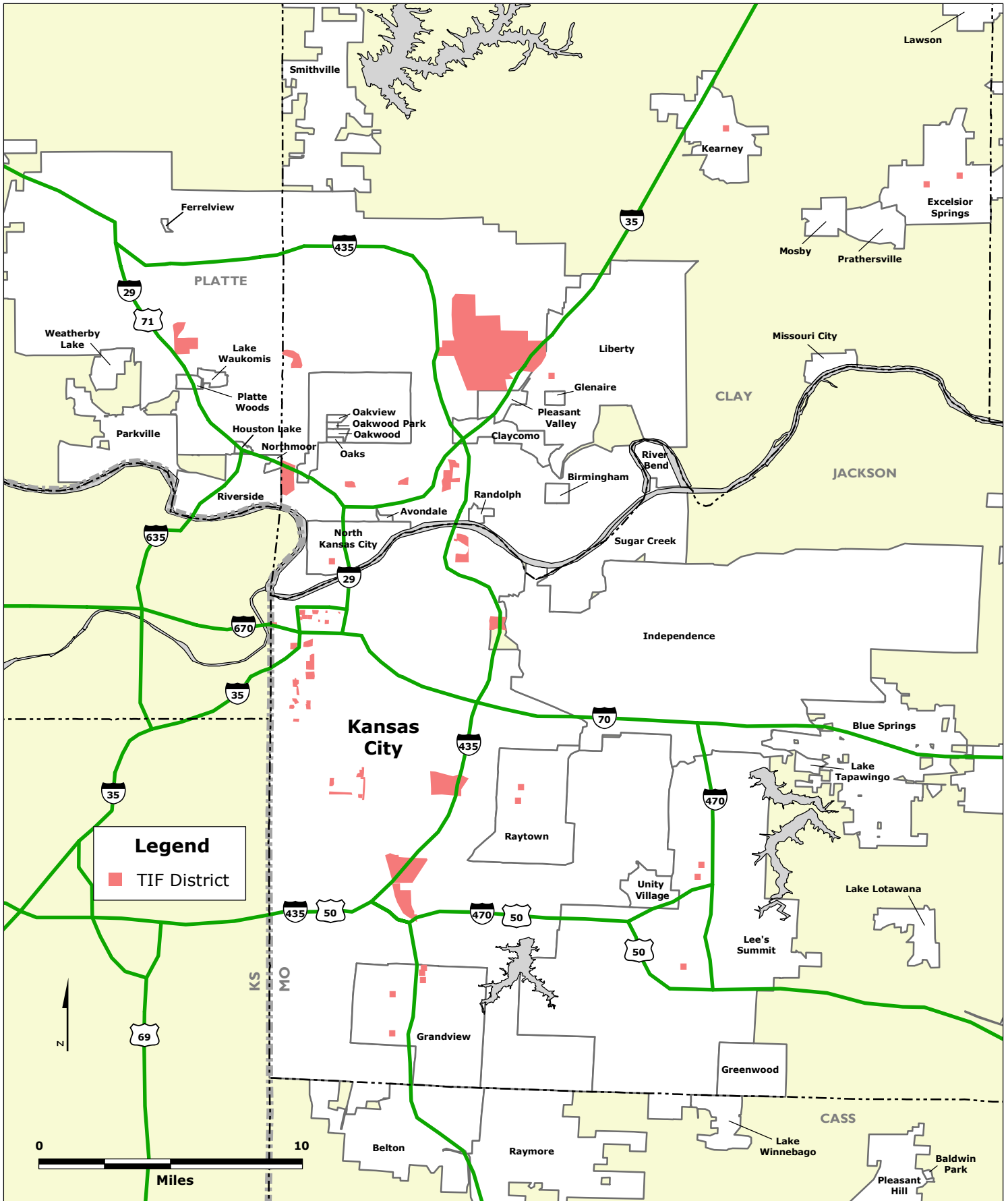
Table 1: Distribution of TIF Districts by City and Function

Metro Area	County	City	# of Districts	Percentage Distribution of Districts by Sector					
				Retail	Retail/Office Combined	Office	Industrial	Mixed	Other
K. C.	Clay	Excelsior Springs	2	100	0	0	0	0	0
K. C.	Jackson	Grandview	3	67	0	0	33	0	0
K. C.	Jackson	Kansas City	40	5	28	25	10	13	20
K. C.	Jackson	Lee's Summit	2	50	0	0	50	0	0
K. C.	Jackson	Raytown	2	50	0	0	50	0	0
K. C.	Total		49	16	22	20	14	10	16
St. L.	Jefferson	Hillsboro	1	0	0	0	0	0	100
St. L.	St. Charles	St. Charles	4	50	25	0	25	0	0
St. L.	St. Charles	St. Peters	2	0	50	0	50	0	0
St. L.	St. Louis	Brentwood	1	0	100	0	0	0	0
St. L.	St. Louis	Bridgeton	1	100	0	0	0	0	0
St. L.	St. Louis	Chesterfield	1	0	0	0	0	0	100
St. L.	St. Louis	Eureka	2	50	50	0	0	0	0
St. L.	St. Louis	Ferguson	1	100	0	0	0	0	0
St. L.	St. Louis	Kirkwood	2	0	50	0	0	50	0
St. L.	St. Louis	Maplewood	3	33	0	33	0	0	33
St. L.	St. Louis	Maryland Heights	2	0	50	0	0	0	50
St. L.	St. Louis	University City	1	0	0	0	0	100	0
St. L.	St. Louis City	St. Louis	6	33	0	0	0	17	50
St. L.	Total		27	30	22	4	7	11	26
	Total		76	21	22	14	12	11	20

Cities with TIF districts but no captured tax base include: Ballwin (1 district), Bel Ridge (1), Crestwood (1), Fenton (2), Hazelwood (3), Kearney (1), O'Fallon (1), Valley Park (2), and Wentzville (1). All except Kearney are in the St. Louis Metropolitan Area.

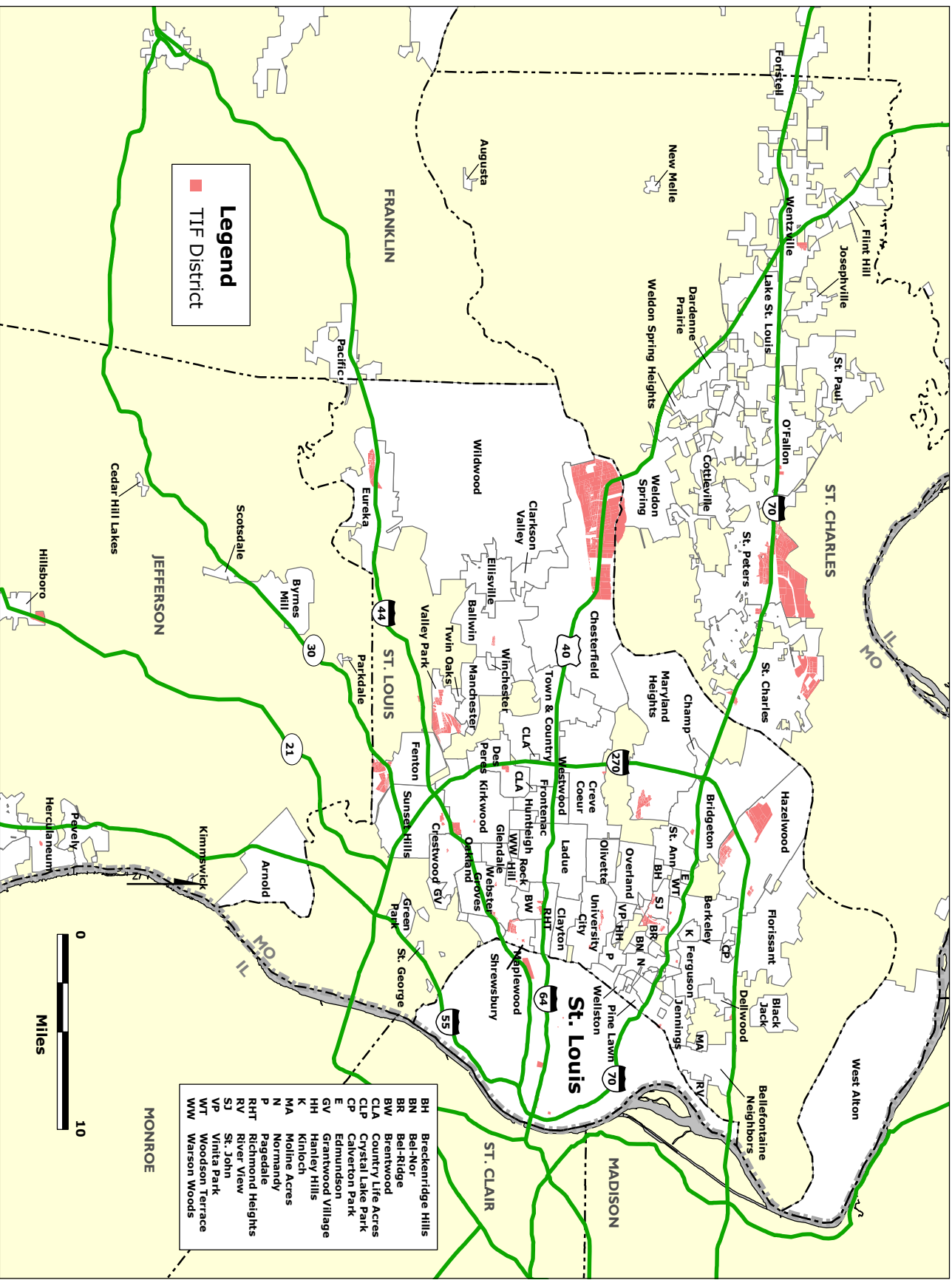
state report. When contacted, local officials provided a much lower estimate for the captured property tax base than that reported in the state report but they could not provide an alternative for the sales tax. The 45 percent figure for the sales tax should therefore be viewed with caution. Local officials were also contacted to confirm the very high percentages in the St. Louis area places with total percentages in excess of 20 percent. The reported percentages were confirmed in those places.

MAP 1: KANSAS CITY REGION Tax Increment Financing Districts



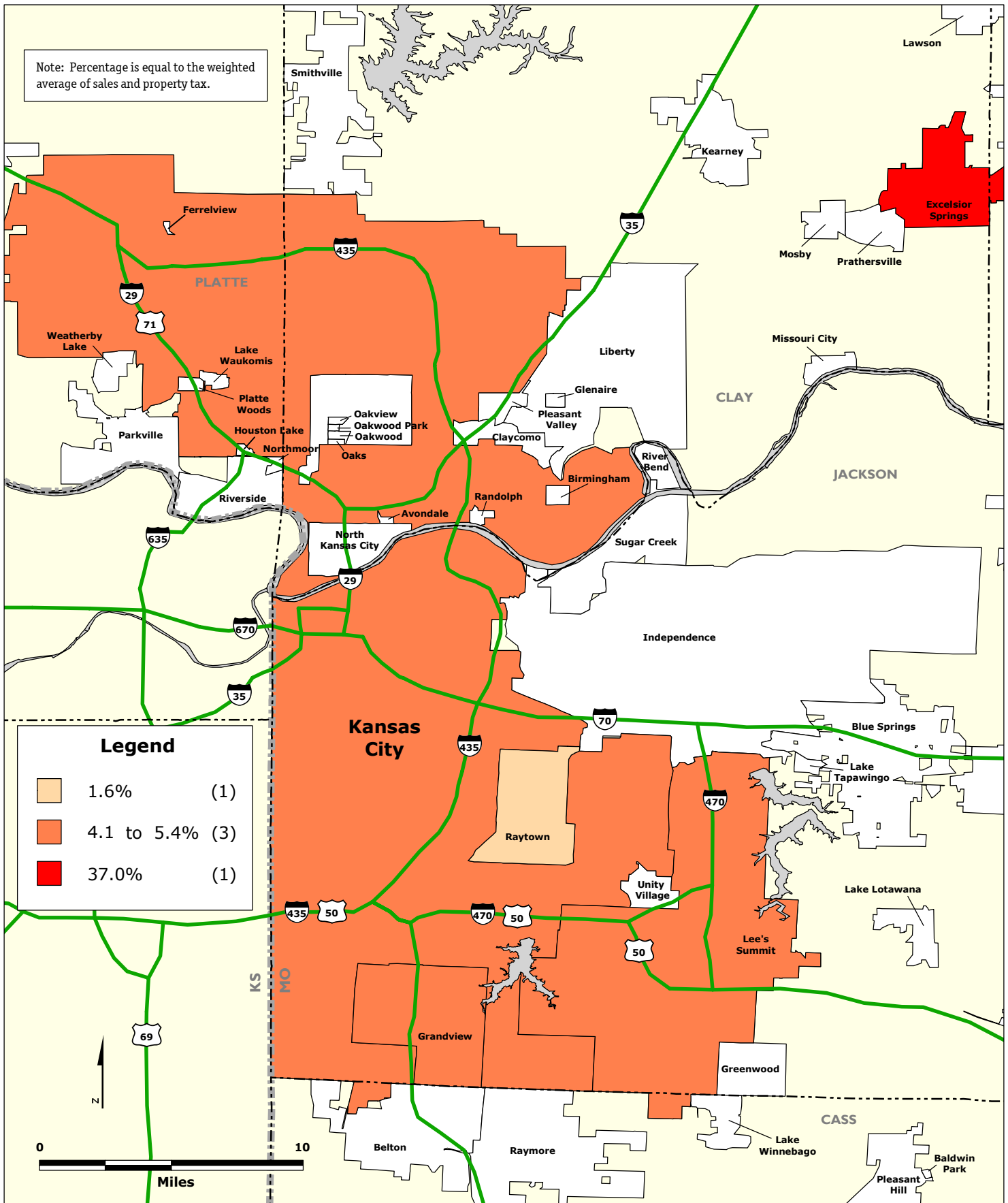


MAP 2: ST. LOUIS REGION Tax Increment Financing Districts



Data Sources: St. Louis and St. Charles County Planning Department; Missouri Department of Economic Developments; East-West Gateway Coordinating Council.

MAP 3: KANSAS CITY REGION Percentage Sales and Property Tax Base Captured by Tax Increment Financing Districts by Municipality





MAP 4: ST. LOUIS REGION Percentage Sales and Property Tax Base Captured by Tax Increment Financing Districts by Municipality

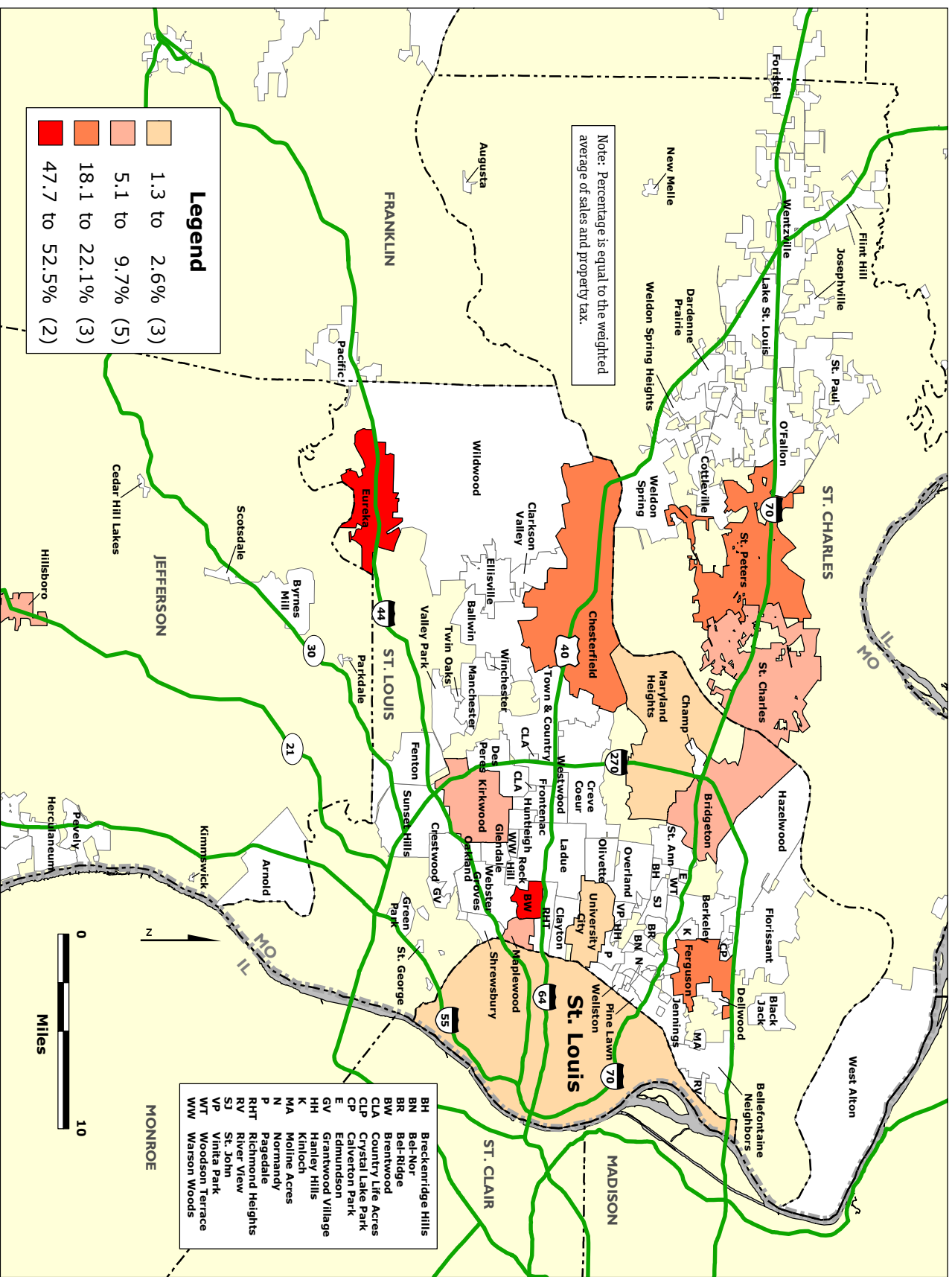


Table 2: 2000 Tax Base Captured in TIF Increments by City

Metro Area	County	City	# of Districts	Property Tax Base		Sales Tax Base		Earned Income Tax Base		Weighted Average Percentage
				Captured	Percentage of Total	Captured	Percentage of Total	Captured	Percentage of Total	
K. C.	Clay	Excelsior Springs	2	4,000,000	6	58,360,300	45			37
K. C.	Jackson	Grandview	3	9,771,225	6	12,469,950	5			5
K. C.	Jackson	Kansas City	40	209,045,399	8	n.a.	n.a.	643,167,653	4	5
K. C.	Jackson	Lee's Summit	2	30,314,264	4	75,030	0			4
K. C.	Jackson	Raytown	2	5,081,119	2	2,753,954	1			2
K. C.	Total		49	258,212,007	7	73,659,234	5	643,167,653	4	5
St. L.	Jefferson	Hillsboro	1	892,414	7	861,455	4			5
St. L.	St. Charles	St. Charles	4	20,207,273	3	51,926,000	6			5
St. L.	St. Charles	St. Peters	2	155,779,704	27	67,346,021	6			18
St. L.	St. Louis	Brentwood	1	68,826,502	39	120,880,521	51			47
St. L.	St. Louis	Bridgeton	1	25,505,404	8	20,513,550	3			6
St. L.	St. Louis	Chesterfield	1	239,863,408	23	137,557,168	19			22
St. L.	St. Louis	Eureka	2	49,222,713	43	74,265,266	58			52
St. L.	St. Louis	Ferguson	1	22,621,585	17	64,069,467	25			22
St. L.	St. Louis	Kirkwood	2	28,260,415	7	4,643,858	2			6
St. L.	St. Louis	Maplewood	3	7,694,200	10	0	0			10
St. L.	St. Louis	Maryland Heights	2	6,286,668	1	11,199,000	2			1
St. L.	St. Louis	University City	1	16,372,835	2	0	0			2
St. L.	St. Louis City	St. Louis	6	93,945,832	5	n.a.	n.a.	98,830,100	1	2
St. L.	Total		27	735,478,955	11	553,262,304	11	98,830,100	1	10
	Total		76	993,690,961	9	626,921,538	9	741,997,753	2	8

Cities with TIF districts but no captured tax base include: Ballwin (1 district), Bel Ridge (1), Crestwood (1), Fenton (2), Hazelwood (3), Kearney (1), O'Fallon (1), Valley Park (2), and Wentzville (1). All except Kearney lie in the St. Louis Metropolitan Area.

Weighted average percentages were computed using weights based on the revenues resulting from the captured tax base.

Sources: See Appendix A.

A primary objective of TIF is to “level the playing field” in the competition for tax base by helping fiscally stressed places with few resources to devote to the competition. It is therefore of interest to compare the characteristics of places that use TIF to those that do not. The TIF district maps suggest that TIF has been used much more extensively in St. Louis by suburban areas with little need for assistance in the regional competition for tax-base. Examining the characteristics of the municipalities that employ TIF confirms this. Table 3 shows how the cities that use TIF compare to the rest of their regions in four dimensions—their per-household property and sales tax bases, the level of poverty in their schools, and how that poverty level has changed over time. Tax base is a good measure of the fiscal condition of individual cities, and the school poverty is a good summary measure of the social needs they face.¹³

In Kansas City, TIF users tend to command lower tax bases than their counterparts who do not use TIF. Four of the six TIF cities have lower property tax bases and five of the six have lower sales tax bases. Three of the six show higher poverty rates and all of them show either increasing school poverty or smaller decreases than the average for non-TIF cities. Overall, four of the six are disadvantaged in either three or four of the four dimensions and these places represent 96 percent of TIF-captured tax base. Only Kearney and Lee’s Summit fare well in the tax base and poverty comparisons, and their characteristics are relatively close to the averages for non-TIF cities.

The TIF-user profiles are significantly different in the St. Louis metropolitan area. Only six of the 21 cities that use TIF are disadvantaged in three or four of the four dimensions, and these places represent just 22 percent of the total tax base captured by TIF.¹⁴ Indeed, five of the TIF cities are disadvantaged by *none* of the measures and these places contain 23 percent of the total captured base.¹⁵ Another six places, representing 22 percent of captured base, are disadvantaged in only one dimension.¹⁶ TIF is clearly being used extensively in the St. Louis area by cities that already fare relatively well in inter-local competition for tax base.

The community classification system developed by Ameregis for its recent study of the 25 largest U.S. metropolitan areas provides another way of examining these issues.¹⁷ The classification system grouped suburban municipalities according to total tax base, tax base growth, population growth, student poverty, racial mix, population density and age of the housing stock. The resulting groups divided suburban municipalities into three “at-risk” categories (places showing clear signs of fiscal stress), a “bedroom developing” category (fast-growing places with average fiscal resources), and two “affluent job-center” categories (places with very robust tax bases and low public-service costs).

¹³ School poverty is measured by the percentage of elementary students eligible for free or reduced-price lunches under the federal Free Lunch Program.

¹⁴ These cities are Bel-Ridge, Ferguson, Maplewood, University City, Valley Park, and St. Louis.

¹⁵ Wentville, Brentwood, Crestwood, Eureka, and Fenton.

¹⁶ O’Fallon, St. Peters, Ballwin, Bridgeton, Kirkwood, and Maryland Heights.

¹⁷ Myron Orfield, *American Metropolitcs: A New Suburban Reality* (Washington: Brookings Institution, 2002).

Table 3: Community Characteristics: Places with TIF Districts Compared to Those Without

Metro Area	County	City	Percent of Total Local Tax Base Captured by TIF	Share of Regional Captured Base	1998 Property Tax Base per Household	1998 Sales Tax Base per Household	School Poverty 1998	Change in School Poverty 1993--98
K. C.	Clay	Excelsior Springs	37	6	78,143	25,288	27	7
K. C.	Jackson	Grandview	5	2	90,031	28,080	39	12
K. C.	Jackson	Kansas City, MO	5	87	102,297	36,511	45	1
K. C.	Clay	Kearney	0	0	117,825	29,003	4	-2
K. C.	Jackson	Lee's Summit	4	3	133,332	22,831	7	-3
K. C.	Jackson	Raytown	2	1	93,553	20,959	16	5
K. C.	Total (Municipalities with TIF)		5	100	105,218	33,649	39	1
K. C.	Rest of Metropolitan Area		0	0	113,728	25,307	21	-4
St. L.	Jefferson	Hillsboro	5	0	82,337	31,353	21	-5
St. L.	St. Charles	O'Fallon	0	0	133,742	41,166	10	-5
St. L.	St. Charles	St. Charles	5	5	99,343	35,392	15	-4
St. L.	St. Charles	St. Peters	18	16	124,222	54,379	9	-6
St. L.	St. Charles	Wentzville	0	0	186,609	79,824	29	-10
St. L.	St. Louis	Ballwin	0	0	137,680	26,958	13	-7
St. L.	St. Louis	Bel-Ridge	0	0	55,858	7,635	73	-3
St. L.	St. Louis	Brentwood	47	14	155,986	65,890	19	-3
St. L.	St. Louis	Bridgeton	6	3	173,977	102,315	25	25
St. L.	St. Louis	Chesterfield	22	27	227,946	37,999	11	8
St. L.	St. Louis	Crestwood	0	0	154,683	80,960	19	-6
St. L.	St. Louis	Eureka	52	9	180,152	65,016	12	-16
St. L.	St. Louis	Fenton	0	0	435,872	354,755	13	-4
St. L.	St. Louis	Ferguson	22	6	68,635	28,194	46	5
St. L.	St. Louis	Hazelwood	0	0	195,963	39,850	12	4
St. L.	St. Louis	Kirkwood	6	2	140,947	24,420	15	-6
St. L.	St. Louis	Maplewood	10	1	60,464	28,197	45	6
St. L.	St. Louis	Maryland Heights	1	1	183,832	78,546	13	13
St. L.	St. Louis	University City	2	1	86,822	12,750	45	-10
St. L.	St. Louis	Valley Park	0	0	95,230	11,810	40	-24
St. L.	St. Louis City	St. Louis	2	14	53,322	25,373	78	0
St. L.	Total (Municipalities with TIF)		10	100	98,164	35,447	48	-3
St. L.	Rest of Metropolitan Area		0	0	114,287	56,866	29	1

Sources: See Appendix A.

In the Kansas City area, three of the five suburban areas using TIF (Excelsior Springs, Grandview, and Raytown) fall into Ameregis' at-risk categories, and the other two (Kearney and Lee's Summit) fall into the bedroom-developing category. In the St. Louis area just seven of the 20 suburban areas using TIF fall in the at-risk categories (Bel-Ridge, Brentwood, Ferguson, Kirkwood, Maplewood, University City, and Valley Park), nine are bedroom-developing (Hillsboro, O'Fallon, St. Charles, St. Peters, Ballwin, Chesterfield, Eureka, Hazelwood, and Maryland Heights), and four are affluent job centers (Wentzville, Bridgeton, Crestwood, and Fenton). These distributions support the analysis based simply on tax base and poverty—TIF is much more likely to be used by non-stressed localities in the St. Louis area than in the Kansas City area.

B. TIF and State Aid for Public Schools

TIF removes a portion of local tax bases from the general tax roles. In particular, in Missouri it removes tax base from the local school district property-tax roles that are used to compute state aid to school districts. This means that, unless all of the economic activity supported by TIF satisfies the “but-for” requirement *from the point of view of the entire state*, TIF activity increases the total amount of state aid that the State of Missouri distributes to local school districts.¹⁸ (See Appendix B for descriptions of the Missouri School Aid Formula, the hold-harmless exclusion, and the method used to calculate the effects of TIF on school aid.)

There is an important exception to this rule. A number of school districts receive levels of state aid determined not by the formula in current law that accounts for local tax base but, instead, under a “hold harmless” clause in the law. When the current aid system was enacted in 1993, the tax-base-equalization portion of the new school-aid formula resulted in allocations of zero aid to a number of school districts—districts with relatively high local tax bases. To ensure that all school districts in the state receive at least as much equalization aid as they received in 1992–93, the law included a clause that held such school districts harmless by allocating aid to them based on an alternative formula that does not include tax base. Since increases or decreases in local tax base have no effect on school aid in these places, excluding TIF-captured tax base from the aid calculation has no effect on the aid that these districts receive.

The hold-harmless clause creates a paradox when evaluating the effects of TIF on school aids. When TIF is used in places with very high tax bases—places that would not normally be regarded as prime candidates for the benefits associated with TIF—it does not increase the amount of school aid that those places receive. Thus, there is a lower dollar cost to state government when TIF is used by these places than when it is used by places that are the primary targets of the TIF law—low-tax-base places that most need the advantages bestowed by TIF.¹⁹

¹⁸ This assumes that the state does not adjust the state aid formula year-by-year in order to generate a specific total amount of state aid.

¹⁹ To some extent this paradox is a short-run phenomenon. In the long run, TIF-captured tax base returns to the general tax roles. One outcome of a well-designed TIF system should be a more equal distribution of tax base across the state's school districts. A more equal distribution of tax bases means that there should be less need for tax-base-equalizing school aids. Therefore, it is possible that TIF actually reduces state school-aid costs in the long run.

Table 4 shows the results of simulations of the effects of TIF on school-aid levels to the school districts containing TIF-captured tax base. The analysis simulates the amount of school aid that each district would have received in 2001 with and without the exclusion of TIF-captured base from the school-aid formula. The analysis assumes that none of the TIF-captured tax base meets the “but-for” criterion from the point of view of the state as a whole. In other words, it assumes that, without TIF, all of the TIF-generated development would have occurred somewhere in Missouri. The measured effects therefore represent upper bounds on the extra costs to the state. If all TIF-generated tax base instead meets the state-level “but-for” requirement, then the state costs are zero. The actual situation almost certainly falls between the two extremes.

Overall, TIF increases state aid by up to 7 percent in the Kansas City-area school districts containing TIF districts, and by up to 5 percent to the districts in the St. Louis area with TIF-captured tax base. The district-by-district percentages vary significantly—from zero percent in hold-harmless districts up to 21 percent in the Fort Zumwalt District in the St. Louis area. The highest absolute cost is associated with the Kansas City School District, comprising roughly a third of the total cost for the two metropolitan areas combined. In most cases, however, the effects are relatively modest—between 2 percent and 5 percent.²⁰

There are eight hold-harmless school districts that contain TIF districts in the St. Louis area. There are none in the Kansas City area. This is consistent with the patterns uncovered in Table 3. Relatively high tax-base places (especially places with high property tax base—the only tax base included in the school-aid calculation) are much more likely to be using TIF in St. Louis than in Kansas City. TIF-associated school-aid costs to the state for these places are zero. However, the characteristic that put these districts into the hold-harmless category (high property tax base per pupil) also means that they are not likely to be good candidates for TIF.²¹

²⁰ The total effect for all of the districts in Table 3, \$22,609,829 represents 1.1 percent of aid distributed statewide under the equity formula in 2001 and .7 percent of total 2001 school aids.

²¹ Two possible exceptions to this are the Maplewood-Richmond Heights and University City School Districts—two of the cities in these districts, Maplewood and University City, show modest tax bases and relatively high school poverty (see Table 3).

Table 4: 2000 Property Tax Base Captured in TIF Increments and Associated School Basic Aid by School District

Metro Area	School District	Captured Property Tax Base	Percentage of Total	2001 Formula Aid Calculation Excluding Captured Base	2001 Formula Aid Calculation Including Captured Base	Difference	Percentage Difference	Hold Harmless Districts
K. C.	Excelsior Springs 40	4,000,000	3	7,984,208	7,858,212	125,996	2	
K. C.	Grandview C-4	351,504	0	7,245,762	7,230,542	15,220	0	
K. C.	Hickman Mills C1	28,424,651	7	17,384,224	16,223,582	1,160,642	7	
K. C.	Kansas City	165,320,313	7	73,044,062	65,430,961	7,613,101	10	
K. C.	Lee's Summit R-VII	30,314,264	4	29,885,564	28,636,617	1,248,947	4	
K. C.	Liberty	10,636,220	3	12,741,804	12,333,372	408,432	3	
K. C.	Park Hill	4,365,952	1	7,355,526	7,166,627	188,899	3	
K. C.	Raytown C-2	14,799,103	3	14,447,228	13,888,659	558,569	4	
K. C.	Total	258,212,007	4	170,088,378	158,768,572	11,319,806	7	
St. L.	Brentwood	68,826,502	36	204,850	204,850	0	0	X
St. L.	Ferguson-Florissant	22,621,585	3	20,498,078	19,434,864	1,063,214	5	
St. L.	Ft. Zumwalt R-II	155,779,704	15	24,286,018	19,176,444	5,109,574	21	
St. L.	Hazelwood	25,505,404	2	23,320,061	22,235,515	1,084,546	5	
St. L.	Hillsboro R-3	892,414	1	6,640,101	6,614,462	25,639	0	
St. L.	Kirkwood	28,260,415	4	862,791	862,791	0	0	X
St. L.	Maplewood-Richmond Heights	7,694,200	5	371,653	371,653	0	0	X
St. L.	Pattonville	6,286,668	1	1,578,523	1,578,523	0	0	X
St. L.	Rockwood	289,086,121	14	9,297,391	9,297,391	0	0	X
St. L.	St. Charles County R-V	11,789,430	9	788,069	788,069	0	0	X
St. L.	St. Charles R-VI	8,417,843	1	6,079,079	6,079,079	0	0	X
St. L.	St. Louis	93,945,832	3	108,412,229	104,409,215	4,003,014	4	
St. L.	University City	16,372,835	5	4,721,300	4,721,300	0	0	X
St. L.	Total	735,478,955	6	207,060,143	195,774,156	11,285,987	5	
	Total	993,690,961	6	378,304,924	355,695,095	22,609,829	6	

School districts with TIF districts but no captured base include: Lindbergh R-VII (St. L., a Hold Harmless district), North Kansas City (K. C.) and Valley Park (St. L.).

Sources: See Appendix A.

IV. CONCLUSIONS

TIF has the potential to be a powerful tool to “level the playing field” in the competition for tax base that occurs in all U.S. metropolitan areas. It can provide resources that otherwise would not be available to fiscally stressed localities to promote economic development and redevelopment. However, poorly targeted TIF laws may also contribute to sprawl by subsidizing greenfield development in high-tax-base suburban areas that need no assistance to compete effectively. Poorly designed TIF laws can further tilt the playing field, increasing the incentives for inefficient inter-local competition for tax base.

The Missouri TIF law clearly creates the potential for overuse or abuse. The blight, conservation, and the catch-all economic development categories are all vaguely defined. In addition, whether a particular use of TIF will result in unfair competition for tax base or violate the “but-for” requirement is a strictly local determination. These factors ensure that the Missouri law invites abuse.

Moreover, it appears that such abuse is taking place in the St. Louis metropolitan area. Nearly 60 percent of the TIF-captured tax base in the St. Louis area is in the region’s outer areas. Similarly, nearly one-half of it lies in municipalities showing none or just one of the four indicators of stress shown in Table 3.

These patterns clearly imply that the law should be revised to: (1) narrow the scope of activities or types of places eligible for TIF; (2) require review of the “but-for” implications of TIF projects by some outside reviewer; and (3) require local TIF administrators to reconcile TIF plans with land use and economic development needs locally and in nearby areas.

If such reforms were put in place, TIF could be returned to its attractive main purpose in Missouri: that of providing resources that would not otherwise be available to localities that badly need them to promote economic development and redevelopment.

APPENDIX A: TIF-CAPTURED BASE CALCULATIONS

Data for TIF districts are from three sources. The Missouri Department of Economic Development's *1999 Annual Report: Tax Increment Financing Projects in Missouri* and *2000 Annual Report: Tax Increment Financing Projects in Missouri*—both available at www.ecodev.state.mo.us/cd/finance/tif.htm—provided data on revenue from TIF-captured tax base in 1999 and 2000 for all districts except those in Kansas City. Data for Excelsior Springs and Maplewood were subsequently modified based on conversations with local TIF administrators. Data for districts in the City of Kansas City came from the *Tax Increment Financing 2001 Annual Report, Volumes 1 and 2*, produced by the Economic Development Corporation, City of Kansas City.

Missouri Department of Economic Development reports do not provide direct estimates of TIF-captured tax base. Instead they show cumulative revenues from TIF-captured property and sales tax base.²² The corresponding tax bases were estimated by computing revenues in 2000 alone (the difference between cumulative 2000 revenues and cumulative 1999 revenues) and dividing by the appropriate local tax rate.

Because data for Kansas City districts in the state reports were not consistent in the two years, annual reports from the Kansas City Economic Development Corporation were used in place of the state data. These reports show estimates of captured property tax base directly and revenue from captured income tax base.

Data on local tax bases, meanwhile, come from three sources. Local property tax rate and tax base data came from the relevant county assessor offices. Sales tax rate and revenue data are from the Missouri Department of Revenue. Income tax base for St. Louis and Kansas City were computed from revenue and rate data available at each city's web site. Poverty data reported in Table 2 are from the National Center for Education Statistics.

²² Revenues from captured sales tax base are not shown for districts in St. Louis and Kansas City. Instead income tax revenues are shown.

APPENDIX B: MISSOURI SCHOOL AID CALCULATIONS

Missouri Basic School Aid Formula:

- | | |
|--------------------------------|--|
| 1. Foundation level of funding | Pupils * operating levy (actual levy or 2.75 mills, whichever is lower) * foundation tax base per pupil (\$1,307.89 in 2001) |
|--------------------------------|--|

Plus

- | | |
|--------------------------|---|
| 2. Tax effort adjustment | Pupils * excess levy (actual levy – 2.75 mills or 0, whichever is greater) * foundation tax base per pupil (\$1,307.89) |
|--------------------------|---|

Minus

- | | |
|-------------------------------|--|
| 3. Tax base adjustment | (lesser of 12/31/94 assessed value or prior year's AV) * income factor (an inflator for high-income places) * operating levy |
| 4. Tax base growth adjustment | (prior year's AV – 12/31/94 AV) * income factor * operating levy |
| 5. Other revenue | Intangible taxes + state railroad and utility taxes + federal property revenue + federal impact aid + proposition C funding + fair share funding + free textbook funding |

Equals

- | | |
|------------------|--|
| 6. Basic Formula | $(1 + 2) - (3 + 4 + 5)$ or 0 if $(1 + 2) - (3 + 4 + 5)$ is less than or equal to 0 |
|------------------|--|

Plus

- | | |
|-----------------------|---|
| 7. At-risk adjustment | (20% of foundation level per pupil from step 1 * free or reduced lunch eligible students) + (30% of tax effort adjustment per pupil from step 2 * free- or reduced-lunch eligible students) |
|-----------------------|---|

Equals

- | | |
|-------------------------|--|
| 8. Direct Apportionment | |
|-------------------------|--|

“Hold Harmless” Calculations:

If the direct apportionment per eligible pupil is less than each of two hold harmless calculations then the district’s basic aid equals the greater of the two hold harmless indicators times the number of eligible students. (Districts in this category are the “Hold Harmless” districts.)

If the direct apportionment per eligible pupil is greater than each of two hold harmless calculations then the district’s basic aid equals the direct apportionment minus the at-risk adjustment (or step 8 minus step 7).

Calculation of the Effect of TIF on School Aid:

The effect of TIF on basic aid levels was calculated by calculating basic aid with and without including the captured tax base in the prior year assessed value in step 4. In hold harmless districts, TIF has no effect on basic aid because the hold harmless calculations (which do not include assessed value) replace steps 1 through 8.

Note: All of these calculations were made using the Basic School Aid Calculation Program available at the Missouri Department of Elementary and Secondary Education web site (www.dese.state.mo.us/divadm/finance/tools/).